Euro wrap-up

Overview

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- Despite the re-imposition of pandemic restrictions in certain member states, and while ECB President Lagarde said that the conditions for an ECB rate hike were "very unlikely" to be in place in 2022, Bunds made losses while the euro area trade surplus narrowed again.
- Gilts also made losses as BoE Governor Bailey said he was "very uneasy" about inflation, the UK labour market looks "tight" and that every MPC meeting is now "in play" for a change in rates.
- Tuesday will bring key UK labour market data as well as updates on euro area GDP and jobs growth.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.738	+0.018
OBL 0 10/26	-0.558	+0.017
DBR 0 08/31	-0.248	+0.015
UKT 0⅛ 01/24	0.532	+0.025
UKT 0⅜ 10/26	0.690	+0.025
UKT 0¼ 07/31	0.943	+0.034

*Change from close as at 4:30pm GMT.
Source: Bloomberg

Euro area

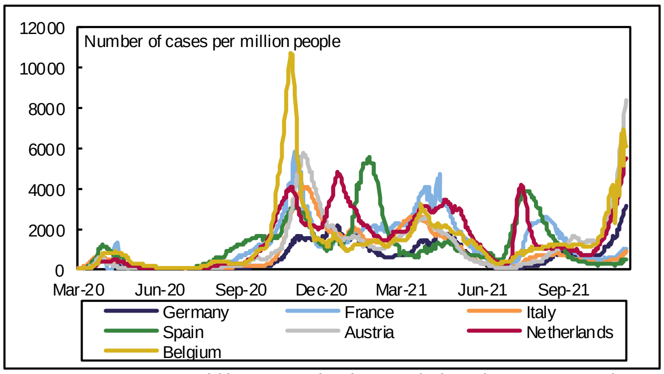
Lagarde upbeat on growth despite spread of Covid and partial lockdowns

In today's hearing at the European Parliament's Committee on Economic and Monetary Affairs, ECB President Lagarde's comments on the outlook for the euro area economy and monetary policy stuck largely to her recent script. So, with respect to economic growth, she remained broadly upbeat. Among other things, Lagarde repeated that the ECB expected the level of euro area GDP to surpass the pre-pandemic level this quarter. Admittedly, she acknowledged that growth momentum is now moderating "to some extent" in response to supply bottlenecks and higher energy prices, which pose ongoing downside risks to growth. But she omitted also to mention the renewed downside risks posed by the pandemic, with recent days having brought a leap in new cases, ICU patients and deaths in several member states, and brought new partial lockdowns in the Netherlands and Austria. In particular, Dutch bars, cafes and restaurants will be subject to vaccine passes and have to close by 8pm, while sports matches can only go ahead without spectators. And in Austria, the 35% of the population that is not fully vaccinated will have to stay home except for reasons of work or buying essentials. In addition, in Germany, coalition negotiators for the SPD, Greens and LDP are reportedly set to be planning national restrictions for the unvaccinated, who might need to present a negative coronavirus test to be able to travel by public transport and visit the workplace. And some German regions have already taken steps to limit access to leisure activities and restaurants to those vaccinated or with virus immunity.

Recovery in household consumption to continue at a moderating pace

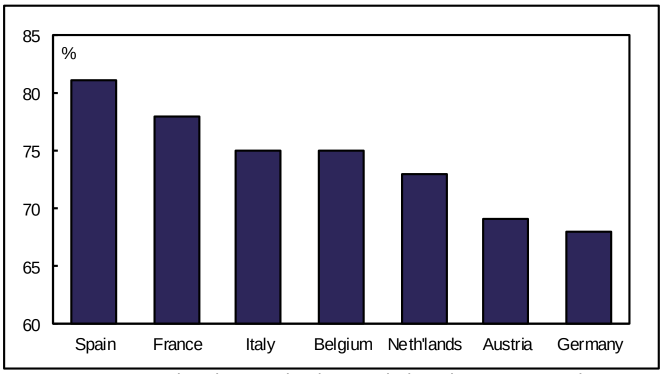
In due course, the tighter restrictions should provide additional incentives for vaccine take-up, as occurred in France and Italy following the introduction of their own vaccine passports. And as in those countries, and also Portugal and Spain where vaccine take-up is among the world's highest rates, that should help to restrain the spread of the pandemic in Germany, Austria and the BeNeLux countries. Nevertheless, over the near term, the restrictions will deliberately limit mobility and are likely to weigh on footfall in retail, hospitality and recreation services. The overall impact on consumer spending in the euro area should not be large, however. After all, the Netherlands and Austria only account for about 10% of the euro area economy, while measures in Germany (which accounted for almost 30% of euro area GDP in 2020) will not be quite so draconian. And, as earlier this year, increased spending online should to some extent compensate for diminished spending in person. But coupled with the impact on real disposable incomes from high prices of energy and other items, overall the recovery in household consumption seems bound to slow, with its return to the pre-pandemic level perhaps not achieved before the second quarter of 2022.

Euro area: Covid cases in selected countries



Source: Our World in Data and Daiwa Capital Markets Europe Ltd.

Euro area: Vaccination rates in selected countries



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Lagarde reiterates that conditions for a rate hike in 2022 are unlikely to be met

If consumers decide once again to shift spending back away from services to goods, that might weigh again on prices of the former while aggravating supply bottlenecks and adding new impetus to prices of the latter. However, with last year's German VAT hike set to fall out of the calculation from January, futures markets pointing to expectations of a notable drop in energy prices in the first half of next year, and supply bottlenecks expected to unwind as the recovery continues, Lagarde reiterated that the ECB still expects inflation to moderate over the course of next year. And alluding to recent subdued settlements data, she also judged that risks of second-round effects of current high inflation of wages and prices "remains limited" even though wage growth is expected to pick up next year. So, she insisted that the ECB also continues to foresee inflation in the medium term remaining below target and thus "very unlikely" to be compatible with rate hikes next year. We share that view of the inflation outlook, and so also judge current OIS market pricing that implies a first increase in the ECB deposit rate before the end of 2022 as misguided. Moreover, with Lagarde repeating that, even after the expected end of the pandemic emergency, ECB asset purchases will need to continue to support the recovery, the possible tapering of net purchases to zero next year – as mooted last week by Governing Council hawk Holzmann – also seems far-fetched to us.

Euro area trade surplus drops to second-smallest since mid-2012

Despite the ongoing global recovery in demand, goods trade continues to be disrupted not least by persistent shortages of key inputs and shipping freight restrictions. Tallying with the further modest decline in euro area industrial production at the end of Q3, today's nominal goods trade figures confirmed a slight drop in the value of exports (-0.4%M/M) for the first month in three in September, with the annual rate of increase (10%Y/Y) easing to its softest since February. This in part reflected a monthly drop in the value of exports to the US, China, and India, although they all remained comfortably higher than a year earlier. In contrast, shipments to Japan rose for a second successive month in September, while the value of exports to the UK rose for the fourth month out of the past five, albeit still leaving them down almost 5% compared with a year earlier and a whopping 23% lower than the pre-Brexit peak in December last year. Despite a further 4.3%M/M decline in the value of imports from the UK (similarly leaving them down by almost one quarter since December), the total value of imports rose a further 1.5%M/M (22%Y/Y). As such, the seasonally adjusted trade surplus narrowed to just €6.1bn, the second-smallest since 2012. And the unadjusted trade surplus stood at €7.3bn, compared with €24bn a year earlier.

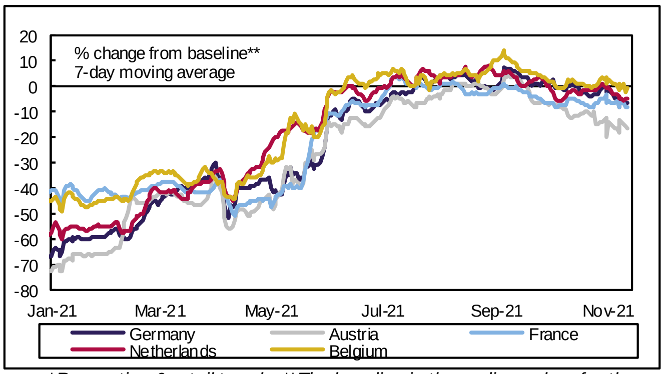
Net goods trade likely supported GDP growth in Q3 as volumes of imports fell faster than exports

Of course, the headline trade figures remain heavily impacted by price effects. Goods import prices rose 1.4%M/M and 17.2%Y/Y in September, and 5.2%3M/3M over Q3 as a whole. As such, goods import volumes probably fell about 2%Q/Q in Q3. While data for producer export prices in September are not yet available, they rose at a significantly softer pace than import prices in July and August, and that likely remained the case at the end of the quarter. Admittedly, export volumes had already fallen for a third consecutive month in August and by 1%M/M (compared with an increase of ½%M/M in values terms), driven by a more than 4%M/M drop in exports of capital goods and ½% decline in exports of consumer goods. As such, export volumes in the first two months of Q3 were trending more than ½% below the average in Q2 and seem highly likely to have fallen at a softer pace than imports over the quarter as a whole. Overall, therefore, net goods trade looks set to have provided a modest positive contribution to euro area GDP growth of 2.2%Q/Q in Q3.

Risks to near-term trade remain skewed to the downside

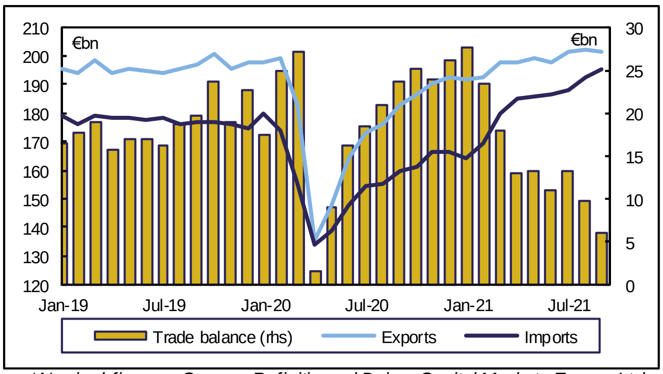
Looking ahead, surveys have recently signalled a further loss of momentum in external demand at the start of the fourth quarter, as concerns of higher prices and persistent pandemic-related disruptions weighed. And while the autos industry continues to be most severely impacted by the global shortage of semi-conductors, manufacturers across a wide range of subsectors expect supply constraints to persist well into next year, which will continue to limit production capacity and

Euro area: Mobility trends in selected countries*



*Recreation & retail trends. **The baseline is the median value, for the corresponding day of the week, during the five-week period 3 Jan – 6 Feb 2020. Source: Google Mobility Reports and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance, exports & imports*



*Nominal figures. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

weigh further on export potential over the near term. While net trade overall, including services, seems bound to have been given a boost in Q3 by the rebound in tourism as international travel restrictions relaxed, the recent rise in coronavirus cases across certain euro area member states might add downside risks to services trade this quarter and into the New Year too.

The day ahead in the euro area

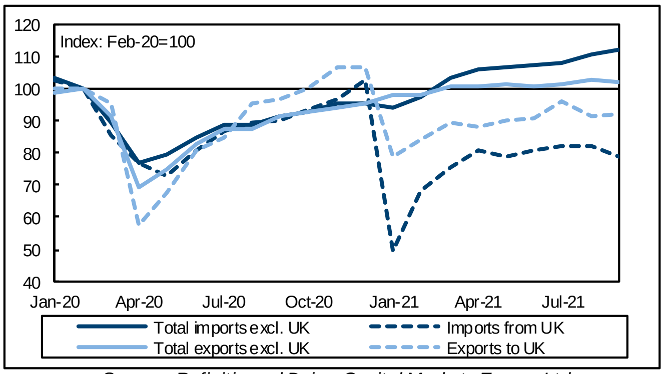
Tomorrow will bring updated euro area GDP figures for Q3, which are expected to confirm the finding of the initial estimate that growth firmed very slightly from Q2 by 0.1ppt to 2.2%Q/Q (we will have to wait for the final release on 7 December for the official expenditure breakdown). These will come alongside preliminary employment numbers for the third quarter, which are expected to report another strong quarter of jobs growth, likely leaving the number of people in work less than 1mn below the pre-pandemic level. Tomorrow will also bring final French and Italian CPI data for October. The preliminary estimates revealed that both countries saw the headline HICP rates rise to their highest levels since the end of 2008, by 0.5ppt to 3.2%Y/Y in France and 0.2ppt to 3.1%Y/Y in Italy.

UK

The day ahead in the UK

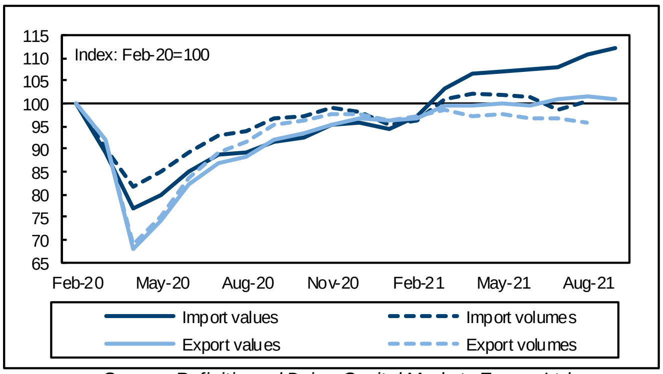
After last week's softer-than-expected Q3 GDP report, in an appearance today before the Treasury Select Committee, BoE Governor Bailey acknowledged that growth had started to flatten out. But he also reiterated that he was "very uneasy" about the inflation situation amid a labour market that he considered to look "tight". So, he insisted that "every meeting" is now "in play" for a rate hike. With developments in the labour crucial for the decision on rates, tomorrow's UK jobs report will be closely watched. However, the data will provide only partial insight into conditions since the termination of the government's Job Retention Scheme at the end of September, when more than 1mn jobs were estimated to have been still supported. But with a recent ONS business survey having suggested that around 87% of furloughed employees had returned to work and only 3% had been made permanently redundant, any pickup in unemployment should prove limited. The claimant count for October might be informative, although these data also reflect low earners as well as the unemployed. And the ILO unemployment rate and redundancy figures will refer to the three months to September and so will not provide a guide to the impact of the end of the furlough scheme. While headline wage growth is expected to have moderated further in the three months to September, this will in part reflect ongoing compositional effects and base effects. However, the ONS' estimate of underlying regular wage growth – which was assessed in August to have risen to between 4.1-5.6%Y/Y – will also be of interest.

Euro area: Export and import values by destination



Source: *Refinitiv and Daiwa Capital Markets Europe Ltd.*

Euro area: Export and import volumes and values



Source: *Refinitiv and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Trade balance €bn	Sep	**6.1**	11.5	11.1	**9.7**
UK		Rightmove house price index M/M% (Y/Y%)	Nov	**-0.6 (6.3)**	-	1.8 (6.5)	**-**

Auctions	
Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Second estimate of GDP Q/Q% (Y/Y%)	Q3	2.2 (3.7)	2.1 (14.2)
		10.00	Preliminary employment Q/Q% (Y/Y%)	Q3	-	0.7 (1.8)
France		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Oct	2.6 (3.2)	2.2 (2.7)
Italy		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Oct	2.9 (3.1)	2.5 (2.9)
UK		07.00	Preliminary output per hour Y/Y	Q3	-	4.3
		07.00	Claimant count rate % (jobless claims change '000s)	Oct	-	5.2 (-51.1)
		07.00	Average earnings including bonuses (excluding bonuses) 3M/Y%	Sep	5.6 (5.0)	7.2 (6.0)
		07.00	ILO unemployment rate %	Q3	4.4	4.5
		07.00	Employment change '000s	Q3	190	235

Auctions and events			
Euro area		16.10	ECB President Lagarde to give an on-stage interview
Germany		10.30	Auction: €1bn of 0% 2052 bonds
UK		10.00	Auction: £1.75bn of 0.875% 2046 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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